Miss Georgia Scholarship Fund, Inc. v. Commissioner, 72 T. C. 267 (1979)

Scholarship payments are not exempt under section 117 if they are compensatory in nature, requiring recipients to fulfill contractual obligations.

Summary

Miss Georgia Scholarship Fund, Inc. sought tax-exempt status under section 501(c)(3) but was denied by the IRS, leading to a declaratory judgment action in the U. S. Tax Court. The Fund awarded scholarships to Miss Georgia Pageant contestants, who were required to sign contracts obligating them to perform various services. The court held that these payments were compensatory, not scholarships, and thus the Fund did not qualify for tax-exempt status as its primary activity was not exclusively for exempt purposes.

Facts

Miss Georgia Scholarship Fund, Inc. was established to provide scholarships to contestants of the Miss Georgia Pageant. The Fund operated in affiliation with the Miss Georgia Pageant Corp. , a 501(c)(4) organization. Contestants were required to sign a contract agreeing to participate in pageant-related events and public appearances. Scholarships were paid directly to educational institutions but were contingent upon the contestant's execution of the contract.

Procedural History

The Fund applied for tax-exempt status under section 501(c)(3) in 1975. The IRS issued a final adverse ruling in 1978, denying the exemption. The Fund then filed a declaratory judgment action in the U. S. Tax Court, which upheld the IRS's decision in 1979.

Issue(s)

1. Whether the payments made by the Fund to pageant contestants qualify as scholarships under section 117 of the Internal Revenue Code.
2. Whether the Fund qualifies for tax-exempt status under section 501(c)(3).

Holding

1. No, because the payments were compensatory in nature, requiring contestants to perform services as a condition of receiving the funds.
2. No, because the Fund's primary activity was not exclusively for exempt purposes as defined by section 501(c)(3), given the compensatory nature of the scholarships.

Court's Reasoning

The court analyzed the nature of the payments under section 117 and related

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regulations, concluding that they were compensatory because they required contestants to fulfill contractual obligations. The court cited precedent, including Wilson v. United States, which established that scholarship payments forfeitable upon non-fulfillment of contractual duties are not true scholarships. The court emphasized that the scholarships were a quid pro quo for services, thus not qualifying under section 117. Furthermore, the court determined that the Fund's operation to provide these payments to attract contestants to the pageant did not meet the "exclusively" requirement of section 501(c)(3), referencing cases like Christian Manner International, Inc. v. Commissioner to support its decision.

Practical Implications

This decision impacts how organizations structuring scholarship programs must ensure that payments are not tied to contractual obligations for services, or risk losing tax-exempt status. Legal practitioners advising non-profit organizations should carefully review scholarship programs to ensure compliance with IRS regulations. For businesses and organizations running similar contests or pageants, this ruling necessitates a clear separation between scholarships and compensation for services. Subsequent cases, such as those involving other pageant or contest-related scholarship funds, have had to address this ruling when seeking or maintaining tax-exempt status.

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